

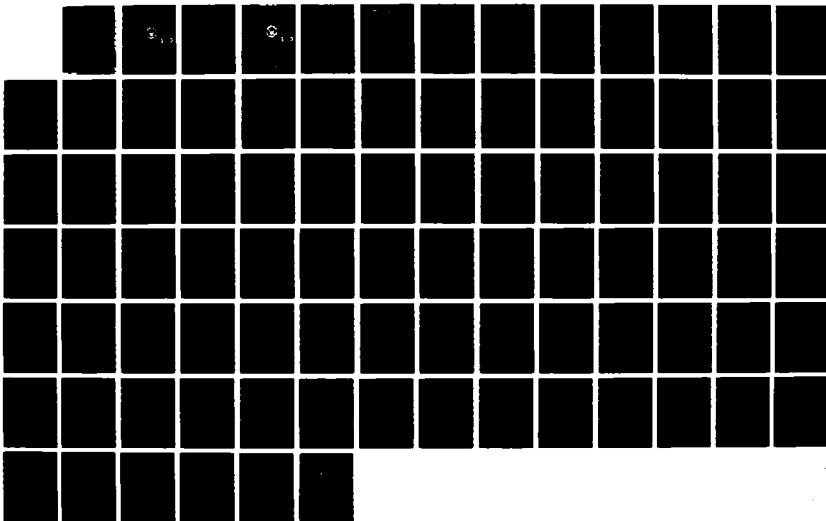
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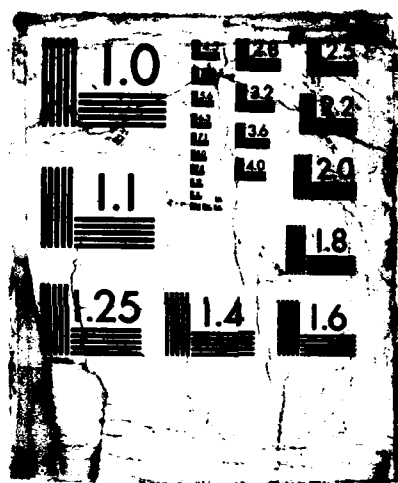
FINANCIAL PLANNING AND CONTROL FOR THE MILITARY OFFICER 1/1  
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**NAVAL POSTGRADUATE SCHOOL**  
Monterey, California



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**THESIS**

FINANCIAL PLANNING AND CONTROL  
FOR THE MILITARY OFFICER

by

Fred R. Hahndorf  
and  
Joseph J. Riggio

June 1984

Thesis Advisor:

John W. Creighton

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Prepared for:  
United States Naval Academy  
Annapolis, MD  
United States Marine Corps

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NAVAL POSTGRADUATE SCHOOL  
Monterey, California

Commodore R. H. Shumaker  
Superintendent

David A. Schradly  
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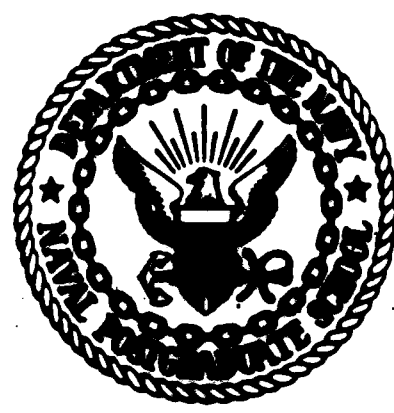
  
KNEALE T. MARSHALL  
Division Dean

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Financial Planning and Control  
for  
the Military Officer

by

Fred R. Hahndorf  
Lieutenant Commander, United States Navy  
B.S., United States Naval Academy, 1974

and

Joseph J. Riggio  
Major, United States Marine Corps  
B.S., Dowling College, 1977

Submitted in partial fulfillment of the  
requirements for the degree of

MASTER OF SCIENCE IN MANAGEMENT

from the

NAVAL POSTGRADUATE SCHOOL

June 1984

Authors

Fred R. Hahndorf

Joseph J. Riggio

Approved by:

James W. Cressy Titon

Advisor

F. M. Cunniff

Second Reader

Richard L. Elton

Chairman, Department of Administrative Sciences

Kenneth T. Marshall

Dean of Information and Policy Sciences

## ABSTRACT

The study is to provide the military officer with a single reference in personal financial planning and control. Pay, benefits, taxes, inflation, budgets, alternatives and various ideas to help the officer become more aware of the power of financial planning and control are discussed. The thesis focuses on the need for the officer to take control and responsibility for his personal finances. It provides a step-by-step guide for formulating a financial plan. The end objective is to provide the Navy and Marine Corps with more efficient and productive officers through improved confidence and awareness of money management. This additional knowledge will enable the officer to better assist his personnel in their financial matters.

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## I. INTRODUCTION

During the past ten years, military personnel have enjoyed a drastic increase in income. While the increase might seem to argue that careful financial planning by officers is less important now, in reality increases in income have led to increased complications in the management of financial affairs. Today's military officers must develop an understanding of the financial world if they are to satisfy their personal needs and desires with a minimum of time and effort. In today's modern all volunteer service, it is essential that an officer develop some proficiency in financial management lest he avoid departing the service for personal financial reasons.

One of the tasks the officer faces then, is how to upgrade his personal financial knowledge in order to fulfill his military and personal obligations. The difficulty, however, is that the officer must perform a balancing act between his job, duties to his family and other commitments while finding time to devote to learning about the world of finance.

### A. PURPOSE

The purpose of this thesis is to provide the military officer with a structured approach to financial planning. It is to serve as a single reference in personal financial

planning in order to aid the military officer in gaining control of his financial life. There are many avenues in which an individual can gain information to design and implement a plan. The design of this thesis is to provide that information, not as an all inclusive reference but as a sound starting point from which to construct a financial plan. The concern of this thesis is to aid the newly commissioned officer or novice in financial planning.

#### B. SCOPE

Today's career military officer is confronted with many personal financial decisions. Chapter II, "Areas of Concern," discusses the potential barriers affecting decision making and blocking the path to financial security. Chapter III, "Pay and Benefits," details a total package look at military compensation. After understanding how military personnel are provided direct and indirect compensation, a more constructive approach to designing a financial plan can be made. Chapter IV, "Income, Inflation and Taxes," is designed to demonstrate officer earning power and the effects of inflation and taxes on income. Chapter V, "Cost and Alternatives for Increasing Earning Power," discusses costs that erode earning power and alternative considerations to stop this erosion. Chapter VI "Philosophy on Saving and Investing Money," discusses the importance of developing a financial plan. Chapter VII "Financial Planning," discusses the why, what and how questions of financial planning. A step-by-step approach is provided

with specific examples in Appendix A. Additionally, Chapter VI discusses goals, guidelines and resources available to complete a financial plan. Chapter VIII contains a summary of the usefulness of this thesis study. Appendix B is an attempt to provide an integrated longitudinal budget study for an officer's 20 year career. Appendix C discusses economic theory and how it applies to the military officer.

## II. AREAS OF CONCERN

### A. FINANCIAL BARRIERS

The military officer will be confronted with personal financial decisions throughout his military career and lifetime. It is difficult for him to decipher the language of finance without a workable knowledge of the financial field. In order to acquire the necessary information to make financial decisions, an understanding of the potential barriers to financial planning are essential. The identification and acknowledgement of these barriers, blocking the path to financial security for the military officer, is the purpose of this chapter.

### B. FORMAL EDUCATION TRAINING

The most difficult obstacle to overcome for the military officer concerning financial planning is the educational barrier of learning money management. The facts of the matter are that large numbers of service personnel are facing financial hardship because they mismanage their funds. By definition, they could almost be categorized as being irresponsible, except for one significant fact: most of them don't know how to manage that pay check they receive every two weeks, and until recently no one has taken the trouble to educate them on how to properly manage their finances (Bronars, 1983, p. 1). The extent the military officer falls into this category of mismanagement is difficult to assess. However, it is important



to review the seriousness of the enlisted personnel mismanagement through data from the Navy Relief Society. By acknowledging their difficulties, the officer can assess his financial educational preparation to deal with these issues as a leader.

The Navy Relief Society provides direct financial assistance in terms of grants and interest-free loans to sailors and marines facing financial hardships. Between 1976 and 1983, the financial assistance provided increased from 5.2 million to 19.2 million, an increase of 369% in five years. The increase from 1982 to 1983 was 275%, with the contributing factor being an increase in clients seeking assistance (Navy Relief Society, 1984, p. 2). The majority of the clients were in E-1 through E-6 pay grades. This accounted for 97% of the total financial assistance provided by the Navy Relief Society. The Army and Air Force statistics show a comparable trend. The Army Emergency Relief Society experienced a 38% increase in financial assistance levels in 1982 compared to 1981, and the Air Force Aid Society a 25% increase (Bronars, 1983, p. 4). From a pure military standpoint, the level of traffic into the Navy Relief Society would represent a minimum of 156,000 man days of lost time. More realistically, approximately 312,000 man days would be lost and considering weekends and holidays, that amounts to somewhere in the neighborhood of 1000 man years--the equivalent of enough personnel to man four Frigates in the Navy or Reinforced

Infantry Battalions in the Marine Corps (Bronars, 1983, p. 12). The importance of these statistics lies in the emphasis they place on the performance of the relief societies and the educational void in financial guidance they are filling. Though not every client receives financial assistance, every client does receive a thorough budget review, counseling and an education on how to manage personal and family finances properly.

The responsibility for administering financial guidance when relief societies cannot be present falls upon the officer community. An assessment of the formal training officers are receiving shows limited exposure to financial education. At the Officer Indoctrination School in Newport, RI, a six-week school, officers are taught to read their "Leave and Earnings" statement but time constraints restrict the possibility of more in-depth financial training (Interview, 1984, CDR Hess). At the Officers Candidate School in Newport, RI, a 17-week school, officers receive three hours of financial education. The three hours are broken down as follows: one hour - financial planning; one hour - personal planning; one hour presentation from the Navy Mutual Aid Association (Interview, 1984, LCDR Grayville). At the United States Naval Academy, Annapolis, MD, midshipmen receive two formal lectures on finance by the Midshipmen Financial Advisor and optional seminars may be attended on Saturdays. Additionally, company officers incorporate in divisional officer training sessions for first class, financial discussions with the Midshipmen Financial Advisor

(Interview, 1984, LCDR Decker). In the Academic Department, no formal course in personal finance is available (Navy Times, 12 Mar 83, p. F9).

The educational barrier in learning money management is apparent by the limited availability of formal training. Until recognition of the educational void regarding personal financial management is acknowledged there will continue to be insufficient resources, insufficient training time and insufficient emphasis on the issue. The military officer must recognize these training limitations and overcome them by independently augmenting his knowledge of financial management. In a questionnaire sent out in January of 1982 to the graduates of 1980 and 1981 classes of the Naval Academy, when asked for additional comments/advice for those you left behind, the common response was "teach us more about personal financial management (USNA, 1980 and 1981, questionnaire). This response did not indicate financial difficulties on their part in general, but rather dismay that more effort was not taken to fill their educational void in financial affairs.

#### C. OUTSIDE FINANCIAL ASSISTANCE

The prudent military officer aware of his lack of knowledge concerning the world of finance will seek outside assistance. The availability of assistance is considerable but is often viewed with skepticism. Anyone can hang a shingle outside his door and call himself a financial planner. The financial planner could be a banker, insurance agent, certified

public accountant or stockbroker (Navy Times, 12 Mar 84, p. 3). Each type of financial planner has his advantages and disadvantages, often with different levels of expertise. Some financial planners charge a set fee for analyzing your financial situation and making recommendations. Some charge a planning fee and a commission for certain investments they sell. Still others, such as stockbrokers or insurance agents, rely solely on commissions.

Skepticism about outside assistance is common because of the officer's lack of familiarity with techniques of financial management. The impartiality of the advisor is difficult to assess. What appears to be independence is often in reality a push of a parent company's product. Furthermore, the attitude on the part of the officers seeking assistance is that professional advisors are only interested in clients with large quantities of money. The transient nature of the military career adds an additional dimension into the decision making process, and often makes it difficult to maintain a team of advisors, such as a lawyer, accountant and broker.

The combination of skepticism, high frequency of moves, lack of financial familiarity, not trusting your money with strangers and the question of whether the assistance is worth the cost, leads to procrastination and no action on the part of many officers. The barrier of seeking outside financial assistance is a stumbling block for many well intended officers developing a financial plan.

#### D. PAY RECORD

The military pay record is complex and variable. It seems Congress and the Department of Defense are continually proposing changes, in amounts, in eligibility requirements, even in creating or abolishing certain types of payments (The Times Magazine, 1983, p. 5). Although staying abreast of all the changes is a monumental task, a basic amount of understanding is essential. Once again, the lack of formal training is responsible for confusion and is the direct cause of military personnel not being able to interpret such important documents as their "Leave and Earning" statement. This document delineates exactly the amount of pay the individual is receiving. It is easy to see how military personnel are overwhelmed when faced with advance pay, special pay, dislocation allowances, variable housing allowance, per diem, and travel pay when they are unable to understand the pay statement. The misunderstanding of the LES and pay system can lead to a variety of difficulties; i.e. failure to report and correct overpayment errors, resulting in hardship when the government recoups its funds; allotment foul-ups caused by the starting and stopping of allotments based on deployments, or the non-receipt of an allotment due to failure to report an address change; drawing advance pay unnecessarily or using the pay improperly to pay off debts, purchase a car or take a vacation between duty stations (Navy Relief Society, 1981, p. 14).

The military officer must be aware of these financial pitfalls and barriers to financial planning. His understanding of the pay record as a leader is essential for the personal enlightenment it gives him in knowing where his money is and the necessary knowledge he needs to answer his men concerning their pay record questions. If an officer fails to understand his pay record, he should seek assistance from his disbursing officer.

#### E. MISCELLANEOUS

The career military officer's transient life style is unique from that of his civilian contemporaries. In many households, a secondary income is provided by the spouse. This secondary income is usually intermittent or nonexistent for military households. Any long term reliance on the secondary income to balance the budget could spell trouble when confronted with a change in duty station. In a questionnaire sent to 1980 and 1981 graduates of the United States Naval Academy, when asked to include spouses' income, most graduates answered that though their spouses sought jobs, they were unable to acquire employment (USNA, 1980 and 1981, questionnaire). The fact that these officers were in a high transient state during their early military training years, made employees reluctant to hire their mates. Prior to reporting to their first duty station the majority of these married officers took for granted the fact that their spouse could work and that this secondary income would help balance

the budget. Awareness of the fact that a spouse may not be able to find employment is critical to a sound financial plan.

Often the problem of dealing with credit cards and the ease of obtaining a credit line is not described as a troublesome area for officers. The truth is that plastic money can be a problem for anyone. Credit cards are designed for convenience, not borrowing. Using credit cards for small purchases can quickly slip an individual deeply in debt (The Times Magazine, 1983, p. 19). The abuse of credit cards such as: borrowing to pay current debts, charging small items, incurring new debts before old debts are paid, running a month behind on credit payments and carrying high balances on several credit accounts, are signs of financial trouble (Navy Relief Society, 1981, p. 14). The questionnaires sent to recent graduates of the United States Naval Academy, once again contain strong advice for future graduates. That advice was to avoid the abuse of credit cards and to remember the 18%-21% interest charge (USNA, 1980 and 1981, questionnaire).

Family separations are never easy on a household and are even less tolerable if the family financial status is not under control. Preparation is the key, but knowing how to prepare and what to expect from a prolonged separation is not always apparent. Many man-hours are lost because of family financial problems that can be attributed to improper preparation of a contingency plan for the unexpected. A true test of a household financial plan's efficiency is during periods of separation.

To face inflation while living with the uncertainty of whether pay will keep pace or will be capped is difficult. An understanding of the potential effects of capped pay raises on a financial plan is essential. If an officer does not make an adjustment in his financial plan for changes in the economy, his financial plan may fail. For example, a capped pay raise may restrict an officer's real growth in pay because taxes and inflation will produce a net result of zero (raise of 4% and inflation of 4% equals a zero increase).

Financial success varies as defined by the individual. For some it means meeting the monthly bills, to others financial success means retiring at an early age. The barriers to financial success are not easily defined nor is there any all inclusive list. The acknowledgement of the preceding pitfalls is a start. Today's military officer cannot afford to sit back and wait for a formal financial education program within the military to train him and keep him out of financial difficulties and provide him with security for the future. The military officer must aggressively seek financial information and learn to avoid the many barriers that stand in his way to establishing and adhering to a financial plan.



### III. PAY AND BENEFITS

#### A. COMPENSATION

In order for the military officer to properly approach the construction of a financial plan he must first have an overall understanding of his military pay and benefits. Congress has directed the Department of Defense to provide military personnel with a "personal statement of military compensation." The purpose of this statement is to provide the individual with a total package look at his military compensation, including direct and indirect compensation.

#### B. DIRECT COMPENSATION

Direct Compensation consists of military pay, incentive and special pay. Military pay is the basic element of compensation paid to all military members. It includes: Basic Pay, Basic Allowance for Subsistence (BAS), Basic Allowance for Quarters (BAQ), and the tax advantage in the amount of additional Federal Tax payable were BAS and BAQ taxable. (Personal Statement of Military Compensation, 1982, p. 1).

##### 1. Basic Pay

Basic pay is what everybody gets. It increases with promotion, increased service and general pay raises. The pay rate tables are designed to avoid "inversions." That means they are set up so that people in one grade won't be making more than those in the grades above who have the same amount of total

service time. The rates are also fixed so that people won't keep getting pay raises just for staying in the service longer. After a point, promotions have to be earned to get more money, with the exception of cost of living increases. The gap between lower grades and higher grades lessens with time. This is referred to as "compression." Congress sometimes reworks the pay tables to widen these gaps. Items tied to basic pay are called "drag along." This means they increase every time basic pay increases. Selective reenlistment bonuses are in this category (the Times Magazine, 1983, p. 7).

## 2. Basic Allowance for Subsistence (BAS)

Basic Allowance for Subsistence began when the practicality of assuring that the military was feeding all its members became impossible. The government, therefore, began paying some people BAS in lieu of furnishing subsistence "in kind." The BAS rate is designed to match the raw food costs of the meals the government prepares and serves in the mess hall. Naturally, on that premise the rate has never come close to buying three mess hall style meals in civilian restaurants. In 1974, Congress ruled that BAS, BAQ and Basic Pay all should be raised at regular intervals. Today, all officers, married or single, draw BAS and pay for their meals, including those in government dining facilities. Additionally, BAS is paid when on leave and while on a temporary duty assignment (The Times Magazine, 1983, p. 7).

### 3. Basic Allowance for Quarters (BAQ)

Basic Allowance for Quarters is an allowance to military personnel for whom government quarters are not available. If authorized BAQ, the amount received depends on pay grades and whether the eligible service person has dependents. Service members with dependents who are furnished quarters are not entitled to BAQ, their BAQ in effect pays for their quarters. Members without dependents who live in government quarters are paid BAQ at a "partial rate." In the case of sub-standard government quarters, occupants receive BAQ in full and pay a rental fee less than the full BAQ. BAQ rates are larger for married people than for single people in the same pay grade. This disparity is often considered unfair by single people. However, many married people wanting government quarters and finding none available find the BAQ rates often inadequate.

Single personnel without dependents of pay grade E-7 and above including all officers have the option to decline government quarters and receive BAQ at the full rate. An exception to this rule are the essential personnel unable to choose to live off base. These personnel receive partial BAQ. An example would be sea duty or field duty in which government quarters are considered to be available and partial BAQ is paid (The Times Magazine, 1983, p. 10).

### 4. Tax Advantage

The tax laws dictate that military Basic Pay is subject to Federal Income Tax, but BAS, BAQ, VHA and overseas housing

pay are not. Therefore, military personnel do not pay taxes on a sizable portion of their income. The resulting tax advantage is not an actual payment in itself, but it is money not received to the government and therefore is available for other use. The tax advantage does represent a cash value and is included in the basic elements of compensation. The actual worth of the tax advantage to people varies depending on grade, years of service, marital status, personal tax exemptions, outside income and whether allowances are drawn in cash (Personal Compensation Statement, 1982, p. 1).

#### 5. Incentive and Special Pay

In addition to Military Pay, certain individuals who possess special skills or are assigned special tasks, receive additional pay. A comparison could be made to the civilian who gets paid by the employer a larger salary for working overseas, performing risky jobs or perhaps receives a bonus to keep his valuable services. In the same manner, the military provides incentive and special pay. Military pay is therefore not one fixed income but a combination of regular military compensation plus dozens of special payments tailored to grade, service, skill and circumstances. The following is a list of some of the more common special pays: proficiency pay, special pay for military doctors, nuclear duty pay, submarine duty pay, sea pay, flight pay, hazardous duty pay, hostile fire pay, foreign pay and diving pay.

## C. INDIRECT COMPENSATION

Indirect compensation is considered to be the supplementation of direct compensation through retirement, health care and other programs. These programs have a cash value in terms of spendable income in that payment is not made out of pocket to obtain these benefits. In adding up real pay value, indirect compensation is important to consider.

### 1. Retirement

After 20 years of service, the serviceman can retire and receive a monthly payment equal to 50% of basic pay for the remainder of his life. For each year exceeding 20 years another 2.5% is added, up to a maximum of 75% at 30 years service. Many private companies and even civil servants pay into their retirement plan and most must wait until age 65 (55 for civil servants) to begin receiving retired pay. To determine the equivalent cost of such a plan for the military, a payment of 7% of basic pay would have to be paid monthly. The savings to the serviceman for not having to pay into such a retirement plan is an indirect compensation (Personal Compensation Statement, 1982, p. 2).

### 2. Medical Care

The degree of medical care usage varies from one individual to another and therefore so does the worth placed upon it. Medical care compensation is therefore determined by the insurance cost for a medical coverage program similar to the military. Civil service personnel may pay \$494 (single)

or \$1170 (family) per year in health insurance payments. The indirect compensation to servicemen is the equivalent amount in savings from free medical service (Personal Compensation Statement, 1982, p. 2).

### 3. Death and Survivor Programs

The death and survivor program, should the serviceman die while on active duty, will provide the dependents a death gratuity (\$3000) and monthly Dependence and Indemnity Compensation (DIC) payments. Furthermore, survivors are eligible for life insurance payments from the Servicemen Group Life Insurance plan provided the low cost insurance was carried by the member. The SGLI plan costs \$4.06 per month for \$35,000 of term insurance and is automatically deducted from the individual's pay. In fact, all servicemen carry SGLI unless specifically an agreement stating they do not desire coverage is signed. The compensation for this death and survivor program is determined by using a 1.7% of basic pay figure to derive a cost of extra insurance needed by the serviceman to carry the same coverage (Personal Compensation Statement, 1982, p. 2).

### 4. Social Security Coverage

Social Security is for military people eligible for old age, retirement, and disability benefits on the same basis as for private sector civilians. The servicemember contributes to social security but the government matches the member's payment on a dollar-for-dollar basis. Therefore, the member is

paying less to social security out of his paycheck. The savings amounts to 6.7% of basic pay, a sizable compensation (Personal Compensation Statement 1982, p. 2).

Total indirect compensation is an important part of the servicemember's compensation and should be used when evaluating total real pay values. Figure 2.1 is an example of total indirect compensation. Figure 2.2 is an example of total direct compensation. Figure 2.3 is a summary of the total compensation a servicemember receives.

#### 5. Expense Allowance

In addition to military compensation and benefits, certain special allowances may be authorized as reimbursement for extra expenses. Normally, without these allowances the individual would have to pay out of pocket, decreasing actual pay for personal use. Reimbursable allowances often cause confusion. The following is a brief description of a few special allowances.

#### 6. Per Diem

Per diem is a reimbursement which is a daily allowance for members on temporary duty (TDY). The rate paid is based on the average actual cost of lodging in an area, plus a specified amount for meals. The per diem rate will vary depending on whether government meals are available.

#### 7. Travel Pay

Travel pay is rather complex and difficult to summarize. In general the services will pay the cost of travel if

Basic Pay \$2,397.30	O-4	10 Yrs Service
<u>Indirect Compensation</u>	<u>Monthly</u>	<u>Annual</u>
Retirement 7% x 2397.30	\$ 167.81	\$ 2013.72
Medical Care (family)	97.50	1170.00
Death & Survivor Program		
1.7% x 2397.30	40.75	489.00
Social Security Coverage		
6.7% x 2397.30	160.62	1927.44
Total Indirect Compensation	\$ 466.68	\$ 5600.15

Figure 2.1: Indirect Compensation

<u>Direct Compensation</u>	<u>Monthly</u>	<u>Annual</u>
Basic Pay	\$2397.30	\$28767.60
BAQ (Quarters)	470.10	5641.20
BAS (Meals)	102.10	1225.20
Fed Tax Advantage	154.86	1858.32
Total Direct Compensation	\$3124.36	\$37492.32

Figure 2.2: Direct Compensation

<u>Type Compensation</u>	<u>Annual</u>
Direct	\$37492.32
Indirect	5600.16
Additional Considerations (estimate)*	2400.00
Total Compensation	\$45492.48

\*Additional Considerations

Commissary and Exchange Savings	\$ 1000.00
Space Available Travel to Hawaii Saving	1400.00
Total Additional Considerations	\$ 2400.00

Figure 2.3: Total Compensation



they cannot provide transportation. The present system provides the servicemember with per diem for lodging and meals, plus a mileage rate. Accompanying dependents receive a flat mileage rate based on age, over 12 one rate, between 2 and 12 a lesser rate. Most travel entitlements apply to PCS moves, but some are also payable on TDY moves.

#### 8. Dislocation Allowance

Dislocation Allowance is payable to most members to offset the cost of settling at a new location. Rates are one month's BAQ for members with dependents. Single members collect one month's "without dependents" BAQ only if not assigned government quarters at the new location.

#### 9. Variable Housing Allowance

Variable Housing Allowance is an allowance for servicemembers drawing BAQ who reside in an area in the continental U.S. where average housing costs exceed their BAQ by 15% or more. The Variable Housing Allowance also applies to personnel assigned overseas if their dependents reside off base and local housing costs exceed BAQ by 15% or more.

Additional allowances that may apply to a service-person's pay are: family separation allowance, overseas station allowance, temporary lodging allowance, clothing maintenance allowance and special clothing allowance (The Times Magazine, 1983, p. 12).

#### D. OTHER CONSIDERATIONS

The total worth of compensation is not complete unless consideration is given to the various other programs and privileges enjoyed by the military. Each individual benefits differently from the various programs and a specific value can only be determined on an individual basis. Other programs of compensation are as follows:

Job Security - steady income, longevity increases and competitive promotion opportunities.

State/Local Tax Advantages - In addition to exemption from Federal taxes, BAQ, BAS, VHA, overseas allowances and in-kind food and housing are not subject to state or local income taxes. Depending on tax laws of the state of residence, these tax advantages can save hundreds of dollars per year to the serviceperson.

Bonus - Service personnel eligible for a bonus or continuation pay such as regular enlistment bonus, selective reenlistment bonus, aviation bonus pay, submarine continuation pay, overseas incentive pay, medical or dental bonuses, should include such pay as a compensation when totaling real pay.

Commissary and Exchange - Congress provides funds for commissary and exchange employee's salaries, transportation, and other costs, so that prices only slightly higher than cost can be charged. The average cost savings to the customer is \$.28 per \$1.00 spent. Monthly purchases of \$300 would save the consumer \$84 (Personal Compensation Statement, 1982, p. 3).

Leave and Holidays - Military members receive full pay and allowances during all authorized absences such as: 30 days leave per year, nine official holidays and unlimited sick leave.

Education Programs - Members in authorized off-duty education programs may have part of their tuition paid by the government, depending on grade and years of service. Members who entered the service before 1977 can get up to 36 months of educational credits at about \$400 per month. This means the individual can get up to \$10,800 in total education benefits paid by the government. Members who use the Veterans Educational Assistance Program may establish an educational account by contributing \$25-100 each month with the government making a two-for-one contribution for a total amount of up to \$8100.

Morale, Welfare and Recreation Activities - Base theaters, bowling alleys, golf courses, child care centers, etc. offer services and entertainment at a much lower cost than most off-base facilities.

Space-Available Travel - Members on leave may travel space-available on MAC aircraft and their dependents may travel space-available outside of CONUS. A \$10 fee is charged for each trip outside the CONUS. This mode of travel provides substantial savings over commercial fares where MAC terminals are accessible.

Many of these benefits are taken for granted or disregarded by the officer. Congress, however, is aware of them and considers these benefits when voting on increased compensation.

Military compensation is more complex than commonly thought and it is every military person's responsibility to be aware of the total compensation package (Personal Compensation Statement, 1982, p. 3).

#### IV. INCOME, INFLATION AND TAXES

##### A. INCOME

The officer and his family can earn a fortune between now and the time they reach age 65. One set of statistics that shows this is based on the person's education level. Figure 3.1 is projected average lifetime earnings of full-time workers in the United States based upon their education levels.

<u>Level</u> <u>Graduated</u>	<u>Lifetime Earnings</u>	
	<u>Male</u>	<u>Female</u>
High School	\$1,041,000	\$634,000
College	1,392,000	846,000
Graduate	1,503,000	955,000

Figure 3.1: Lifetime Earnings by Education Level

Since all officers are at least high school graduates, it can be said they will earn over a million dollars (Sylvia Porter's April, 1984, p. 40).

Each officer is unique and variations in the military pay system can cause large differences in yearly pay and thus life earning. An officer can figure his income up to this point in time by using his income tax W-2 form and income tax returns from the previous years. The Personal Statement of Military Compensation can be used for 1982 and 1983 to give a more accurate picture of the compensation received. Review of the total earnings an officer and his family receive can give the officer a different point of view on his spending patterns

(the form in Appendix A will help compile these figures). If he sees that \$100,000 or \$250,000 has passed through his control, he might ask: Where did the money go? Following are some of the answers to that question.

#### B. INFLATION

Inflation is a major problem affecting the officer's family's ability to achieve financial goals. Inflation is constantly eroding the purchasing power of the dollar. Military pay went up 45.2% from 1973 to 1980, but inflation negated that rise. Pentagon officials calculated that the average "real" military income fell between 11 and 18 percent in that period. Congress approved large pay raises for military people in 1980 (11.7%) and 1981 (10-17% depending on the pay grade). But then in 1982 and 1983 the pay raises were "capped" and held below inflation (The Times Magazine, 1983, p. 5). What pay raises are in the future no one knows except that the attitude of Congress seems to be additional "capped" pay raises. Inflation for the remainder of this century has been forecast to run between 6% and 7% annually (USPA/IRA Spring Letter, 1984, p. 6). Even at this rate, the purchasing power of the dollar will be cut by 50% in 10 to 12 years. A sum of \$50,000 in 1984 will be equivalent to \$98,000 in 1994 with a 7% inflation rate.

#### C. TAXES

Taxes are constantly eroding the officer's income. The IRS is a lifetime partner, demanding a patriotic share of whatever

profit or income you earn. One of the simplest ways to determine the tax effect of additional income (pay raise) is to use the marginal tax rate. To understand how this concept works, Figure 3.2 is used to illustrate the difference in tax on a taxable income between \$11,900 and \$16,000.

<u>Taxable Income</u>	<u>Tax</u>	<u>Marginal Rate</u>
\$16,000	\$2,265	861
<u>-\$11,900</u>	<u>-\$1,404</u>	<u>      </u> = 21%
4,100	861	4,100

Figure 3.2: Calculating Marginal Tax Rate

This means that \$.21 of every \$1.00 of taxable income between \$11,900 and \$16,000 goes to the federal government in income tax. On the other hand, every \$1.00 of deductible expense that reduces the taxable income between \$11,900 and \$16,000 represents \$.21 in taxes saved. This is an excellent tool to help make financial decisions because it takes into account the tax effect of various alternatives.

Overpaid income taxes unnecessary drains on an officer's income. Figures 3.3 and 3.4 illustrate the dramatic effect taxes can have on an officer's financial plan with the use of an Individual Retirement Account. If an officer were in the 33% tax bracket and he put \$2,000 into a 10% savings account, at the end of the year it would be worth \$1,421 because of the tax rate. That same \$2,000 put into an IRA account at the end

of the first year would grow to \$2,200 because of the tax advantage.

<u>At End of Year</u>	<u>IRA Acct 33% Rate</u>	<u>Savings Acct 33% Rate</u>
1	\$2,200	\$1,421
2	2,420	1,516
3	2,662	1,617
4	2,928	1,725
5	3,221	1,840
6	3,543	1,962
7	3,897	2,092
10	5,185	2,537
15	8,350	3,500

Figure 3.3: IRA Tax Advantage

	<u>With IRA</u>	<u>Without IRA</u>
Total Income :	\$25,000	\$25,000
Contribution :	<u>2,000</u>	<u>none</u>
Adjusted Gross Income :	23,000	25,000
Tax Due*	3,288	3,760
Savings	472	0

\*1983 Tax Tables, Joint Return

Figure 3.4: Increased Savings with an IRA Account

Figures 3.3 and 3.4 show how an officer can gain in "real" dollars by considering strategies in tax planning. An officer can use the sheet in Appendix A to figure the amount of taxes paid in the past by getting information off previous federal and state income tax forms. If an officer usually gets a refund and it is \$1,000 or more (year after year), he should consider increasing his exemptions by using the W-4 form. This



would increase his monthly cash flow and enable him to invest it during the year instead of getting a large lump sum at the end of the year with no interest. If the officer is not residing or does not intend to return to the state in which the officer was a resident at the time of entry into the service, the officer may have taxes withheld from the state in which he was a resident at the time of entry into service. If he is not residing, or does not intend to return to that state for residence, why pay that state tax? The officer can change his legal residence to any state, six of which do not have income tax. These include Florida, Nevada, South Dakota, Texas, Washington and Wyoming. A simple trip to the Legal Officer for the details could add to the officer's "real" dollar investment plan.

The point is that the officer should make sure that he pays in taxes everything that the law requires, but nothing more. The officer as a taxpayer should attempt to avoid incurring tax liabilities, but should be sure not to evade them. Tax avoidance is proper and is expected by tax officials. It can be accomplished by careful planning and knowledge of how tax laws should be applied. Responsibilities in the tax area can be met by keeping adequate records, planning to avoid all unnecessary tax liabilities and submitting accurately completed tax forms as required. As the officer can see, however, the better understanding he has of the income tax system itself, the better prepared he will be to reduce his income tax liability and increase his "real" dollars.

#### D. INFLATION AND TAXES

The insidious phenomenon of bracket creep is caused by wage inflation which pushes an officer into a higher tax bracket even though no gain in additional purchasing power was made. Just to maintain his "real" dollars (dollars that he can really spend), an officer must have his dollars compound at a rate that is at least equal to the rate of inflation plus taxes--and that's just to break even.

If an investment yields a 10% gross return, after taxes it may pay 7% in spendable dollars. If inflation is at 7%, the yield of the investment leaves no provision for growth. If inflation exceeds 7%, and it was as high as 13% in recent years, the officer loses buying power. It can be seen then, that an officer must plan ahead with an eye on inflation and tax consequences.

## V. COSTS AND ALTERNATIVES FOR INCREASING EARNING POWER

### A. COSTS

The "Where did the money go?" question is also treated in an Air Force survey on permanent change of station (PCS). The survey results were carried in the Navy Times on April 16, 1984. They showed that PCS costs to members were up to 40% higher in 1983 than in 1982 (\$1519 in 1983, \$1079 in 1982). Further breakdowns are shown in Figure 4.1.

	<u>Officers</u>	<u>Enlisted</u>
Total Expenses	\$3222	\$1978
Reimbursements	803	459
1983 Out-of-pocket	2419	1519
1982 Out-of-pocket	1790	931
% Increase	35%	37%

Figure 4.1: PCS Out-of Pocket Cost

Almost 60% of those moved had to borrow money from credit unions to finance the government-ordered move. These results are based on responses of 3,261 Air Force members to an internal survey. Seventy-seven percent were married and 23 percent single. Forty-seven percent were officers and 53 percent enlisted. The results generally reflect the experiences of all military travelers, for all services reimburse members at the same rate for PCS moves.

The survey asked for information on costs for meals, transportation, lodging, car shipment, household goods, quarters preparation, house hunting, auto expenses and other costs

before, during and immediately after the PCS moves, exclusive of home-ownership costs. The results showed that the government reimbursed members only one dollar for every four dollars spent to move. Married respondents paid \$1991 (76% of total costs) in median out-of-pocket expenses to move. For single respondents the median cost was \$767 (82% of total costs). To put these out-of-pocket costs in perspective the \$1,969 median loss reported by O-3's represents approximately 23 months of the 4 percent pay raise passed January 1984. Further breakdowns are shown in Figure 4.2.

<u>Type Expense</u>	<u>Cost</u>
Temporary Lodging	\$ 533
Auto	419
House-Hunting	299
Loss of Second Job	290
Loss of Spouse's Job	588
Damaged/Lost Goods	118
Loss on Sale of Auto	1135
Depreciation of Auto in Storage	1114
Selling House	7625

Figure 4.2: Out-of-Pocket Expenses

A joint-service study on VHA sent to Congress April 2 calls un-reimbursed moving expenses "one of the most significant elements of negative compensation associated with duty in the uniformed services."

"Service members are not only at a distinct financial disadvantage, but the financial penalties are repetitive due to the frequency of PCS moves over the course of a career. These financial difficulties are compounded because, in many cases, military members are faced with

the prospects of having to reenter the house market at inopportune times and quite frequently at higher interest rates than previously experienced. Closing costs alone can be devastating to the member. Since service members receive no financial assistance to help them enter or leave the housing market, the end result is less disposable income for the service member and his or her family," the study says (Navy Times, 16 April 1984, p. 1).

Another answer to the "Where did the money go?" question is the automobile. Most people underestimate the annual costs of owning and operating an automobile. In 1982, the average amount approached \$2,850. "Total costs" range from 18.9 cents a mile for a subcompact to 26.6 cents for a large model, according to a Department of Transportation pamphlet. An average 1982 compact costs 44 cents a mile during the first year; a typical used compact drops to 25 cents according to Hertz (rental car agency).

An automobile can take as much as 25% of an officer's net income when he includes all costs. These costs include such factors as: where he lives; what kind of car he drives; where he drives it; distance traveled each year; length of ownership; whether he bought it new or used; and whether he paid cash or financed it. Without considering inflation, he can figure that driving a 1982 compact 10,000 miles for a year and then trading it would cost about \$5,100. Keep it four years and reduce the annual outlay to \$4,585. Keep it for ten years and the annual costs drop to \$3,384, thereby saving about \$17,160 compared with yearly trading (Rogoff, 1984, p. 88). The more you know about costs, the more you can save.

## B. ALTERNATIVES FOR INCREASING EARNING POWER

The surveys point to areas where an officer's money can go and how his earning power is eroded. This section points out some alternatives that the officer has and might consider to maintain or increase his earning power.

The officer might consider two alternatives to help in avoiding the inevitable losses involved in exchanging of a home. The first is not to buy. Overall, for similar housing and considering factors such as income tax deductions for taxes and interest, renting will cost less than buying over short periods. The second is don't sell the house, rent it. By renting the house he occupied for only two or three years, he gains in four ways:

1. He avoids the direct loss of cash for settlement costs.
2. Operating income from rent that is higher than all costs yields a positive cash flow which is partly sheltered from taxes through depreciation.
3. Loan repayments build equity in the house.
4. Appreciation increases the apparent value of the asset, and this increasing value helps to offset inflation (Navy Times, 23 January 1984, p. 28).

The car expense has a number of considerations. If the officer wants to purchase a new vehicle, he can save a substantial amount by purchasing the vehicle through a computer service, fleet dealer or car broker. A computer service such as Car/puter (800) 221-4001, offers a computer readout on a particular

make and model which lists the dealer costs. This provides an excellent bargaining tool to use with local dealers. Fleet dealers are listed in the Navy Times and car brokers can be found in the yellow pages or through telephone information. By saving on the initial purchase of the vehicle, the costs will be reduced in the areas of finance charges, taxes, depreciation, insurance and often licenses and fees. The money saved from these services can be used to reach other family goals.

If an officer is considering trading his present vehicle for a new one because of gas mileage, he might consider these calculations. If the new vehicle would get 50% better gas mileage than the older vehicle, it could take 10 years to break even on mileage alone. For example: if the present car gets 15 mpg and a new car would get 30 mpg, you buy 1,000 gallons of fuel per year (15,000 miles of driving) and it costs \$1.40 per gallon. His present gas bill would be \$1,400 per year while the 30 mpg vehicle would cost \$700 per year. If the new car cost \$10,000, it would take 14 years for a payback on the improved mileage.

If the old vehicle needs some repairs, have a competent mechanic take a hard look at the car. Ask for an estimate on the detailed list of everything that's wrong and needs to be repaired. Even if the vehicle needs major work such as a rebuilt transmission (\$400), tires (\$500), paint (\$400), upholstery (\$200), brakes (\$100) and miscellaneous (\$100), that would add up to \$1700. With that kind of renovation, a

vehicle should be good for another five years with no major repair expenses. The \$1700 would probably be equivalent to the interest charge on a new vehicle loan. It would be cheaper to repair the old vehicle than to buy a brand new one ("Fixing Your Old Car," 1984, p. 1).

Another source for saving lies in food purchase. Through the use of coupons, both for use at the commissary and restaurants, an officer could save through a little planning. The coupons are found in newspapers, magazines and by writing to the manufacturers. The restaurant coupons usually offer early dinner specials and two-for-one dinners. These could provide for an affordable night out.

Other means by which the officer can increase his purchasing power is temporary lodging and travel. Two excellent books that could help are: Military Travel Guide and Military Space-A Air Opportunities. The first book contains information on 250 major military installations in the U.S. which can provide assistance and save money for the traveling military family. These services include inexpensive lodging, medical care and auto repair. The second book has over 250 listings of installations in the U.S. and overseas which offer Space Available Air opportunities (military aircraft that have available seats). Whether on leave or orders, this could provide a substantial savings in travel. For example: an active duty member can travel from Travis AFB, California to Hickam AFB, Hawaii for \$10.00. Round trip from



California to Hawaii for a family of four costs \$80.00 (Space-A) vice \$1500 on a commercial flight. The \$1420 difference could be applied to other family needs.

## VI. PHILOSOPHY ON SAVING AND INVESTING MONEY

### A. THE IMPORTANCE OF FINANCIAL STRATEGY

Attitudes on saving and investing money vary widely among individuals. How an officer feels about money and how he handles it is often reflective of his personality. When developing a financial plan, it is important that one's financial strategy be in harmony with his personality. There are conservatives, risk takers, and middle-of-the-road types. Knowing where one fits or his comfort zone is important, because how one feels about money can be more important than what one does with it.

Another attitude consideration is security. Security is essentially a state of mind and means different things to different people. This state of mind, however, often eludes people because of fears they have not put to rest through planning. Job security in the military does not put to rest these fears, nor does a guaranteed pension. The truth is that no matter what an individual's age or rank, security lies in the judicious management of his limited resources. If an individual only worries about the future, but demands the pleasures of the present, security may always elude him (Harris, 1983, p. 68).

In formulating a financial strategy, personal attitudes are the key. Only the individual can develop a strategic plan that fits his life situation. Two examples of financial

strategies are provided in this chapter to demonstrate the conservative and risk taker, opposite ends of the spectrum.

#### B. BASIC CONSIDERATIONS FOR A FINANCIAL PLAN

When developing a financial plan, an officer must walk before he can run. Essentially this means covering the basics first. The basic includes saving for an emergency, adequate life insurance, and securing a place to live. Once these important basics are under control and one has increased his disposable income, he can develop his financial strategy. To get the kind of serious money needed to save and invest, an officer must master the discipline of regular saving. If an individual chooses to save what he has left over at the end of the month, he may end up saving nothing. He needs to consider savings as a regular expense in his budget (Jorgensen, 1984, p. 157).

#### C. SAVINGS VS. INVESTMENT

To plot a basic financial strategy, an officer's best move could be diversification. Diversification is to balance defensively by dividing funds among securities of different classes. To diversify, he must understand the difference between saving and investing. Savings accounts are primarily for accumulating short-term money. The interest earned is one's only reward for letting other people use the money. If inflation rises or an individual is trapped in a long-term fixed rate savings account when interest rates soar, he loses.

During periods of rapidly compounding inflation, he can actually lose a great deal more in purchasing power than the gain from the interest he earns on his account. A savings account example might be a Christmas or vacation fund in which the time period is short term and the availability of cash is needed. Savings accounts generally do not provide the important long-term objectives of growth and tax savings. A house, for example, is a long-term saving that promises price appreciation and tax savings. A savings account can only promise to someday return one's original deposit and one's accumulated interest income (Jorgensen, 1984, p. 159).

An investment is an outlay of money usually for income or profit. The investor hopes for a return on his money and the possibility of appreciation on his assets, but nothing is certain. A blue chip stock, for example, could provide current income from dividends and the expectation of a rise in the price of the stock. Investments are a means of providing for a sound financial future.

Until one's late thirties or early forties, building a family and getting set up in life is perhaps of primary importance. During this time, large day-to-day expenses can consume a great deal of one's income, with part of an officer's disposable income being funneled to such items as education funds, adequate family protection, or the annual vacation. The investment strategy an officer chooses will reflect his life situation and the degree of risk he is willing to take.

#### D. INVESTMENT STRATEGY CONSIDERATION FOR A NO-RISK PERSONALITY

Generally, with a no-risk personality, an officer wants to get the greatest return with the lowest risk he is willing to take. The no-risk personality should therefore plan an investment strategy on a combination of high-yield money market funds and one or more conservative or growth stock funds. The overall strategy is to balance these two funds depending on the ups and downs of the financial market plan. When interest rates are high (over 10% on savings accounts), move most of one's assets into money funds. When interest rates fall and the stock market starts to take off, move back into the stock funds. Diversification is an important consideration and therefore a strong reason for not investing in an individual stock. Mutual funds provide good diversification by spreading out risk, are easily moved from fund to fund, and are managed by experienced investors (Jorgensen, 1984, p. 160).

#### E. INVESTMENT STRATEGY CONSIDERATION FOR A RISK PERSONALITY

A risk taker should look for tax-favored investments to regain as much as possible from Uncle Sam. An example would be limited-partnership tax shelter that invests in shopping centers, apartment complexes and other properties. An example of the higher risk portfolio might be the consideration of stocks in emerging industries with the intention of packing them away and hoping for the best. Another consideration might be to purchase the stock of the investment companies

that run the equity funds (i.e. Fidelity - offers a variety of investment vehicles), if one finds the most aggressive mutual funds too tame. The investment strategy considerations of the risk personality provide greater flexibility within a financial plan. However, the small investor should keep in mind that the fast pace, big profit deals are few and far between and that hot tips are often long cold before the public hears about them (Jorgensen, 1984, p. 163).

## VII. FINANCIAL PLANNING

### A. WHY SHOULD ONE HAVE A FINANCIAL PLAN?

Employed people spend most of their time working for money, and very little time making sure that what they have already earned is working for them. Their controls over their financial security tend to be based on expediency and haphazard planning. If an officer should die or become disabled, his family will have to live within the limits of the financial plan he has devised (The Times Magazine Handbook, 1983, p. 5).

In our great American nation with its vast natural resources, educational institutions, and industrial might, all types of opportunities abound. In spite of this, statistics tell us that only slightly more than 5 percent of all Americans who have reached the retirement age are truly financially independent. Another 15 to 20 percent must continue to work beyond age 65, often under physically handicapped conditions. The remaining large majority of retirees are dependent to one degree or another on friends, relatives, or charity to keep body and soul together (Meyer, 1984, back cover).

Those who do not achieve financial independence do not plan to fail, they simply fail to plan. This is especially true of the people who are beginning their working careers. They simply do not understand the great value of time as a fertilizer for dollars, the importance of identifying long-range objectives, the importance of developing a plan to

achieve these objectives, and, most importantly, "sticking with it." (USPA & IRA Spring Newsletter, 1984, p. 3)

Although there are many reasons for failure to achieve financial success, it usually results from a lack of effective planning for the future. Regardless of a family's standard of living, income, and goals, there is nearly always a way to provide for long-range needs. Financial success can be achieved with only an average income by understanding and applying the basic principles of financial programming, by saving effectively, and by protecting the family against the ravages of depression, inflation, and the unexpected (USPA & IRA Introduction, 1984, p. 3). This can be done by starting a financial plan.

A financial plan is needed because we live in uncertainty. Income could be interrupted by premature death, disability, retirement, or involuntary unemployment. Needs could be greatly increased if a substantial portion of one's personal assets, such as a home, car, or other personal property were destroyed. Thus the officer must somehow decide how to allocate his income to satisfy both his current economic needs and protect his family against such personal hazards (Officer's Manual, 1973, p. 46).

A financial plan can help a family control its money and, like a business, to derive a profit from its earnings and spending. Family "profit" can be defined as long-term financial security, a higher standard of living, and confidence in



dealing with money matters. The single key to these desirable family financial goals is an organized system for controlling your family's finances. Control involves planning, spending according to plan, and monitoring.

Most financially successful individuals attribute their success to hard work and financial planning -- planning which established certain goals and planning they followed to achieve those goals. They didn't start off with thousands of dollars to invest. In fact, some of the most financially successful people in the world started with virtually nothing more than a plan--a Financial Plan!

Financial planning can help provide for financial security and peace of mind knowing that one's family is protected in the event of one's death or disability. It can help fight inflation and higher taxes. It is a means of enabling an individual to acquire some of the things he wants out of life. A financial plan helps gain the goods and services one's family wants most.

#### B. WHAT IS FINANCIAL PLANNING?

Financial planning is a set of goals and steps to reach them. It is a systematic way to control spending, develop alternatives from which choices can be made and provide some flexibility for achieving specific goals through selective spending. Financial planning is a system that enables an officer and his family the opportunity to get the most out of life from his available income, no matter what level that may

be. Only he can develop a plan that fits his income, his needs and his life style.

#### C. HOW TO START A FINANCIAL PLAN

The most difficult aspect of financial planning is to actually get one started. It is easy to procrastinate and "put off until tomorrow" because financial planning is not a hard fact of life like death and taxes. But death and taxes are two of the most important reasons why a financial plan should be started.

Various companies and groups have differing ways to start a program and include the same basic elements. These elements are:

1. Data on family - name, age, social security number.
2. Analysis of present financial status.
3. List of goals.
4. Establishment of a strategy to attain goals.

Total financial planning should include the factors of: assets and income, insurance, income tax plan and estate plans.

Now that some ways have been listed, what is a good way to actually get started? One of the best methods for starting a financial plan is to work the plan on a step-by-step basis (Meyer, 1984, p. 20). These steps include all of the basic elements and once started can be used to build on for years to come. Appendix A includes examples of each step.

- Step 1: Develop a simple list that includes personal data, family data.

Purpose: Gets plan started with data that's fairly familiar. It provides a starting point for someone else to settle an individual's estate. It provides a central reference for any type of future application.

- Step 2: Develop a second list which provides the names, addresses and telephone numbers of individuals having an important role in one's personal life and affairs.

Purpose: Same as step 1.

- Step 3: Prepare a family "balance sheet" listing the value of items (assets) and the amount owed to others (liabilities). Information on value of assets and amount owed can be obtained from bank statements, credit card slips, receipts, cancelled checks, catalogs and estimations.

Purpose: Provides a "snapshot" of the financial position. Provides a very convenient measuring device to compare against future balance sheets in determining the success of the financial planning efforts. Determines net worth (assets-liabilities) that financial planning is designed to increase and protect.

- Step 4: Record present income and expenses covering a monthly period (quarterly and yearly plans can be done later). Information can be obtained from leave and earning statements, bank statements, credit card statements, receipts, cancelled checks and estimates. (See chapters on cost and considerations and guidelines section.)

Purpose: Provides a preliminary budget on which to base financial decisions. If income exceeds expenses, decide on how

to allocate money to established goals (Step 5). If expenses exceed income, decide on whether to reduce expenses (and which expenses) and/or increase income.

- Step 5: Establish goals and write them down (see following section on goals). Goals should be realistic.

Purpose: Reaching a planned goal is a rewarding experience; focuses energies and concentration; provides motivation to take action on the plan; starts a priority process.

- Step 6: Establish a simple plan to achieve goals.

From this point one can use his own knowledge and seek advice from various experts and specialists to get alternatives to obtain goals. It should be one's own decision as to which alternative(s) to choose. This would take into consideration risk and tolerance to it, and the time set to achieve goals.

Sequence of actions: Develop an insurance program for future protection; build an "emergency" savings account (see guidelines) and use the account only for true emergencies; establish a solvent financial situation where day-to-day financial needs can be taken care of without creating a financial crisis; and develop a sound and continuing program of savings and investments.

Purpose: To make decisions in order to reach established goals. To establish a base course of action on which to continue towards goals or from which to alter.

- Step 7: Put financial plan into action. Each day of delay is a day of risk and uncertainty too.

- Step 8: Review financial plan at least once a year. Better to review semi-annually so that adjustments can be made for possible changing situations, including unexpected deployments, temporary duty, sale of a home or changes in tax laws.

Purpose: To keep financial plan updated. To check programs towards goal.

#### D. GOALS

For a financial plan to work, an officer must establish goals to motivate himself and his family to work toward achieving them. Goals motivate an individual into action. If an officer doesn't know what he wants, he won't be motivated to work on his financial plan. A study at Yale University pointed out the value of goals. Members of the 1954 graduating class were asked if they had set any specific written financial goals at graduation. Only three percent had done so and wrote their goals down. Another ten percent had specific goals but hadn't written their goals down. The remainder had no specific goals. After twenty years had passed the class was resurveyed. The original three percent had out-performed the other ninety-seven percent combined! (Allen, 1983, p. 23)

The hardest part of financial planning is to get started. The second hardest part is to establish goals and write them down. This is difficult because people sometimes do not know what they want. In a family situation different members might have different goals which cause conflict in the family and goal avoidance. However, until one writes out his goals, he

may not be aware of conflicts regarding how money should be spent. To try to develop these goals, a family brainstorming session could be used with everyone participating. The key question is - "What do we really want?" Find out what interests the individual and his family members. Everyone should express, freely, his/her own wants and needs. These should not only include the "necessities" but everything--vacation trips, clothes, cars and houses. A goal is something one wants--whether one "needs" it or not.

Evaluate each item on the list using these criteria:

1. Is the item tangible or intangible? Tangible items exist and may be measured in terms of cost, size or some physical means (i.e. car, house). Intangible items are more difficult to measure or define and may include education, music appreciation or other activities difficult to evaluate.

2. What is the time factor? Short-range goals could be three months, intermediate goals within a year, long-range goals extend beyond one year.

3. What is the priority? A meaningful set of family goals can be developed by examining each item cost in terms of money, time and effort and evaluating the importance of each item relative to other items. Prioritize the items so that you and your family can decide which ones are most important.

The list of goals can be refined and reworked. With this part completed, an officer can now use his financial plan to work to achieve his goals.

## E. GUIDELINES

This section is included to provide guidelines in determining costs and dollar amounts for savings, insurance, etc. It only serves as a primer to get one's financial plan going. Each individual should adjust the figures according to his own situation. Figure 6.1 lists budgets, according to percentages, in four different situations. For example, if an officer is married with no children, he would be situation status B. He could then use the table to get a percentage of the budget normally spent in a particular budget category.

Example: A married officer with no children would be in situation status "B." His approximate cost for housing would be 25-30% of his budget. If his net pay is \$2,000, his housing cost should be \$500-\$600 ( $\$2,000 \times .25$ ;  $\$2,000 \times .30$ ).

Emergency Fund: Emergency fund should be two to three months' take home pay.

Savings: Some families establish their financial plans by devoting a fixed percentage of their income to a systematic savings and investment program. The typical percentages run between five and fifteen percent of gross income (Officer's Manual, 1973, p. 135).

Debt: Debt counselors and credit managers generally agree that no more than 20% of disposable income should be committed to installment debt. If \$3,400 a month is made, installment payments should normally not exceed \$680. Fran Smith of the American Financial Services Association, a

<u>Situation Status</u>	<u>Age(s)</u>	<u>Annual Income</u>			
A. Single	25	\$25,000			
B. Married - No Children	33, 32	40,000			
C. Married	44, 41	60,000			
D. Married	64, 58	30,000			

Situation Status	A	B	C	D
<u>Budget Category</u>	<u>Percentage of Budget</u>			
Housing	20-25	25-30	30	10-15
Loan Payments	13-15	15-17	13-15	-
Food	10-15	10-15	10-15	15-20
Entertainment	7-14	5-12	6-14	14-19
Out-of-Pocket Expenses	8-12	7-10	5- 8	10-12
Transportation	7-10	7-10	5- 8	10-12
Clothing, Personal Care	4- 7	8-10	4-10	1- 5
Education	5- 7	-	5- 7	-
Utilities	4- 7	7- 9	4- 7	15-18
Gifts, Contributions	2- 7	1- 3	2- 5	1- 7
Savings	5- 7	5- 7	5- 7	1- 5
Insurance	1- 3	3- 5	3- 5	1- 5
Medical	1- 3	3- 5	5- 7	15-20

Figure 6.1: Percentage of Budget in Different Situations  
Budgets (Harris, 1983, p. 71)

finance company trade group has stated: "Debt is a highly personal thing. Some can handle a lot much more comfortably than others." Another factor to consider in arriving at debt threshold is size of an individual's emergency fund. Another way to find value more specific to one's situation is by estimating current disposable income: income minus all withholdings (including contributions to various IRA, savings and investment plans). The net result is cash flow--disposable income.



#### F. RESOURCES AVAILABLE

The military officer has a number of resources available to him in developing his financial plan. As stated throughout this thesis, each individual officer is unique and knows what is best for him and his family. Armed with his financial plan he need only seek out these resources and ask for their assistance. He must go to them, for most assume that officers know what they are doing with their finances. Each officer can choose the resource he feels will help him meet his financial goals. This is not an all inclusive list but it does cover the main resources that are available.

1. Navy and Marine Corps Family Services Center - trained counselors, as well as information on community resources.

2. Base Legal Office - can review contracts and leases and advise on legal residents.

3. Consumer Credit Counseling Centers - financial counseling and consumer education. Located in all major cities and sponsored by the National Foundation for Consumer Credit.

4. Credit Unions and Savings and Loan Associations - officer financial counseling.

5. Navy Relief Society - financial aid, counseling and guidance are available.

6. Personal Finance MCI 34.20 - excellent free correspondence course. Send request to Marine Corps Institute, Marine Barracks, Washington, DC 20013.

7. "Personal Financial Management Course," NAVSO P-3607 (May 81) ordered by using DOD Single Line Item Requisition, DD Form 1348, send to Commanding Officer, Naval Publications and Forms Center, 5801 Tabor Avenue, Philadelphia, PA 19120. (Stock No. 0515-LP-945-9050)

8. "Officer's Manual of Personal Finance and Insurance: Principles and Techniques for the Armed Forces Officer" third edition. Edited by Major James Golden and Captain William Taylor. Stackpole Book, P.O. Box 1831, Harrisburg, PA 17105, \$9.95.

9. "Sylvia Porter's Money Book: How to Earn it, Spend it, Save it, Invest it, Borrow it - and Use it to Better Your Life," by Sylvia Porter.

10. 1984 Financial Planning Guide for Military Personnel by Dyke F. Meyer and Walter A. Yohey Jr., carried by Navy and Marine Exchanges.

11. The Navy Times Magazine Handbook for Military Families, Navy Times, yearly insert, 103 pgs.

12. Navy Times.

13. "Moneyline" on CNN TV.

14. "How to Save Money on Life Insurance," NICO, 344 Commerce Street, Alexandria, VA 22314, \$7125.

### VIII. SUMMARY

The purpose of this thesis is to provide the military officer with a single reference in personal financial planning and control. It is to serve as a guide in forming a financial plan so that an officer may maximize the use of his limited resources. The thesis presented areas of concern, alternatives, examples and various ideas to help stimulate the officer's awareness of the power of financial planning and control. The ultimate objective is to motivate the officer to pick up a pencil and start writing out a financial plan. He need only follow the steps listed in Chapter Seven, Financial Planning. To ease the starting process, examples of the different forms are provided in Appendix A. The financial plan is expected to assist the officer in his effort to help himself. The thesis is to encourage the officer in developing a financial plan to ultimately achieve his own goals.

The financial plan is used as a base on which the officer can make decisions. His goals are defined and the limited resources can be used more effectively since a plan is in effect. The financial plan provides feedback on where the officer has been, where he is going and a way to measure his effectiveness (i.e. net worth increasing/decreasing or the same each year).

With a financial plan the officer gets more actively involved. The financial decisions he makes will directly determine his future life style and financial security. By using the financial plan, the officer takes charge of his own finances and learns how to manage his own money.

Money management is a skill and like any other skill, it can be learned. Many officers have not been trained in the discipline of money management, either at home or as a part of their formal education. Yet, they have a basic responsibility for keeping personal affairs in order, which certainly includes the management of money. In addition, officers have as a duty to offer assistance to subordinates in financial planning and preventive counseling, to help these individuals cope intelligently with money management. For it isn't likely that a person who is preoccupied with money worries or family problems related to money problems will give full attention to his military duties.

An officer's first responsibility is to his service and country. A very close second, is his responsibility to his family. It is his responsibility, and his alone, to organize his affairs so that they can continue undisturbed through all the ups and downs while serving in the military. Because of uncertainty, many contingencies must be anticipated. Death, disabling injury, capture, passover for promotion, early retirement, unaccompanied overseas tour or temporary assigned duty are just a few possibilities which should be reflected on.

The financial plan will serve as a tool to help ease the financial burden of these possibilities. It provides a means of control and a way to achieve the officer's self-determined goals.

# APPENDIX A

\*\* Information Sheet \*\*

Date: 4/30/84

<u>Name</u>	<u>Soc. Sec. No.</u>	<u>Birthplace</u>	<u>Birthday</u>
John Smith	241-07-6417	Denver, Colo	June 6, 1952
Mary J. Smith	111-10-1795	Atlanta, Ga	May 9, 1954
John Smith Jr.	125-63-1411	Monterey, Ca	May 6, 1976

## Military Information

Enlisted Date : 6/11/71  
 Commission Date : 11/ 1/72  
 Started Flying : 3/15/72  
 Earliest Retirement Date : 12/ 1/92

## Date of Rank/Promotion

<u>Grade:</u>	<u>O-1</u>	<u>O-2</u>	<u>O-3</u>	<u>O-4</u>	<u>O-5</u>
<u>Date :</u>	11/1/72	2/1/74	7/1/77	7/1/83	?

Gross Pay Month: \$3,410.50 (from LES - Total Entitlements)  
 Net Payment : 3,013.02 (Gross - Fed & Soc. Sec. Tax)

\* Use latest Leave and Earning Statement if more detailed information needed.

\*\* Use Military Compensation Sheet supplied by pay centers yearly to realize total compensation for each year.

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**\*\* List, Location of Important Documents \*\***

<u>Document</u>	<u>For</u>	<u>Location</u>	<u>As Of</u>
Will	John	22 Main St. Monterey, CA	12/82
"	Mary	"	"
Power of Attorney	"	"	"
Marriage License	John/Mary	Safe Deposit Bank America	"
Divorce Decree			
Social Security Records			
Property Deeds			
Mortgage Records			
Life Insurance Policies			
Trust			
Stocks			
Tax Documents			

=====

**\*\* List of Contacts \*\***

<u>Capacity</u>	<u>Name/Address/Telephone</u>	<u>Remarks</u>
John's Parents	Charles & Mary Smith 12 South Street Miami, Fl 32140 (722) 719-3241	Dad heart problem
Mary's Parents	Frank & Sue Pet 10 North Street New York, New York 12576 (518) 947-7621	Mother is deaf

Lawyer  
 Insurance Agent  
 Clergyman  
 Banker  
 Tax Advisor  
 Executor of Estate  
 Children's Guardian  
 Married Children  
 Squadron Contacts  
 Others

=====

**\*\* Previous Addresses \*\***

King Henry Estates #83 450 Mobile Hwy Jacksonville, Fl 23714	Jan 73 - March 74
127 Sherwood Rd North Park, NC 98798	April 74 - June 77
"	"
"	"
"	"
22 Main Street Monterey, Ca 95123	Dec 82 -

=====



**\*\* List of Accounts \*\***

<u>Name/Address/Phone Numbers</u>	<u>Type &amp; Acct #</u>
Navy Federal Credit Union	Shares: 2614
Washington, DC 20391	Sh/Ck : 2614A
(408) 373-2725	
Armed Forces Co-op Ins. Assoc.	Life: 1764
Fort Leavenworth, Kansas 60621	
(800) 255-6792	
"	"
"	"
"	"
USAA	Auto: 1259
USAA Bldg.	
San Antonio, Texas 78288	
(800) 321-0425	

**\*\* Insurance Information \*\***

<u>Life</u>	<u>Co.</u>	<u>Type</u>	<u>Cost Yr.</u>	<u>Coverage</u>
John	SGLI	Term	\$ 50.00	\$ 35,000
"	USPA	Term/Whole	408.00	70,000
"	Arm Forces	Term	294.00	150,000
John's Total			\$752.00	\$255,000

**\*\* Wages to Date \*\***

<u>Yr</u>	<u>Wages</u> <u>(W-2)</u>	<u>Running</u> <u>Total</u>	<u>Fed</u> <u>Tax</u>	<u>FICA</u>	<u>State</u> <u>Tax</u>
71	1,460	1,460	138	70	50
72	6,447	7,907	867	282	150
73	9,064	16,971	875	397	160
83	37,519	275,361	5,357	1,958	John
83	6,098	281,459	700	300	Mary

**\*\* Balance Sheet \*\***

**Assets**

**Accounts**

Bank America	\$5,000
Navy Federal	500
Mutual Fund	500
Checking	200
Gold	500
Silver	1,000
Total :	<u>7,700</u>

**Personal Property**

House Furniture	\$30,000
Clothes	5,000
Jewelry	3,000
Cars	20,000
Coin Collection	500
Total :	<u>58,500</u>

**Real Estate**

House	74,000
-------	--------

Total : 74,000

Total Assets : 140,200

Total Liabilities: 60,500

**NET WORTH 1983**

TOTAL ASSETS	:	\$140,200
TOTAL LIABILITIES	:	<u>60,500</u>
NET WORTH	:	\$ 79,700

=====

**\*\* Budget Worksheet \*\***

**Monthly Income (net - after taxes)**

John	\$3,000
Mary	<u>400</u>

**Total : \$3,400**

**Monthly Expenses**

Rent or Mortgage	\$750
Utilities (Gas, Water)	100
Telephone	1000
Groceries	350
Eating Out	100
Car Gas	50
Laundry	20
Barber	10
Cigarettes	-
Clothing	50
Subscriptions	25
Car Insurance	50
Life Insurance	100
Personal Property Insurance	25
Donations	20
Recreation	50
Car Payments	200
Charge Payments	50
Savings	300
Other	50

Total Expenses :	\$2400
Total Income :	<u>3400</u>
Net Income :	\$1000

**\*\* Goal List \*\***

Started January 84

<u>Item</u>	<u>Cost</u>	<u>Target Date</u>	<u>Remarks</u>
Television	\$ 600	June 84	\$100 month to bank
Vacation, Hawaii	2200	Dec 84	\$200 month to money mkt
Computer	1000	Feb 85	Use income tax return
Emer. Fund	6000	Jan 85	\$500 month to money mkt
Investment	300	Monthly	9% of gross to mutual fund

**\*\* Net Worth Record \*\***

<u>Year</u>	<u>Name, Age</u>	<u>Tot Assets</u>	<u>Tot Liab.</u>	<u>Net Worth</u>
	John/Mary/John Jr			
1982	30 28 6	130,200	50,500	69,700
1983	31 29 7	140,200	60,500	70,700
1984	32 30 8			
"	" " "			
"	" " "			
"	" " "			
1992	40 38 16			

## APPENDIX B

This appendix is an attempt to provide an integrated longitudinal budget study for an officer's entire career. Figures B.1, B.2 and B.3 cover income for 20 years, expenses based on net income, and expense factors over the 20 years. It is based on the following facts and assumptions:

### Facts

1. Commission year: 1970
2. Earliest retirement: 1990
3. Aviator
4. Present year: 1984
5. Married: two children ages 12 and 8
6. Officer's age: 35
7. Promotion years: 1970 (O-1), 1972 (O02), 1975 (O-3), 1981 (O-4)
8. Eight moves with two other moves expected. Total of 10 moves in 20 years of service.
9. No prior enlisted service.
10. 1970 to 1983 actual figures used.
11. Three one-year unaccompanied tours.
12. Lived in government quarters for 10 of the 20 years in service.

### Assumptions

1. Promotion to O-5: 1987
2. Retire with 20 years as O-5
3. Retire at last assigned duty station
4. Military only source of income
5. 1984 to 1990 based on 1984 pay tables with base pay adjusted for 4% pay raise per year.
6. Expense factors are average costs.

<u>Years</u>	<u>Wages</u>	<u>Fed Tax</u>	<u>FICA</u>	<u>Net Income</u>
1970-83	\$261,000	\$43,300	\$13,200	\$205,400
84	40,900	6,500	2,000	32,400
85	44,700	8,200	2,200	34,900
86	48,900	12,800	2,200	33,900
87	54,400	13,000	2,600	38,800
88	55,900	13,600	2,700	39,600
89	57,200	14,100	2,800	40,300
90	58,900	14,700	3,000	41,200
Totals	\$622,800	\$126,200	\$30,700	\$465,900

Figure B.1: Income for 20 Years

Military Lifetime Retirement Pay: \$432,700 (Meyer, 1984, p. 17)

Wages + Retirement Pay = Total Military (Gross) Pay  
Total Military (Gross) Pay for 20 years: \$1,055,500

<u>Budget Category</u>	<u>%</u>	<u>\$ for 20 Yrs</u>
Housing	30	\$139,770
Loan Payments	10	46,590
Food	10	46,590
Entertainment	5	23,295
Savings	10	46,590
Transportation	10	46,590
Clothing, Personal Care	10	46,590
Other (Dental, Education)	15	69,884
Total	100%	\$465,900

Figure B.2: Expenses Based on Net Income of \$465,900

<u>Item</u>	<u>Cost</u>
1. Moves (10 x \$1,000)	\$10,000
2. Houses (2 x \$5,000)	10,000
3. House Down Payment	15,000
4. Cars (5 x \$6,000)	30,000
5. Unaccompanied Tours (3 x \$4,000)	12,000
6. Promotions (5 x \$500)	2,500
7. Dental	6,000
8. College	20,000
	<hr/>
Total	\$105,500

Figure B.3: Expense Factors Over the 20 Years

#### Explanation of Expense Factors

1. Moves - expenses not covered by the government, such as the set-up costs of a house (phone, drapes, etc.)
2. Houses - cost of the maintenance and improvements, i.e., lawn, painting, etc.
3. House Down Payment - first house purchased with Veteran's Benefits (no down payment). Second house purchased by a conventional loan requiring 10% down payment.
4. Cars - at retirement will have two cars that are paid for.
5. Unaccompanied Tours - extra expense of maintaining two households. Items include increased phone bills, mail costs, and transportation home during the year.
6. Promotions - includes the cost of the required new uniforms when going to the rank of O-4 and social obligations ("wetting down" party).
7. Dental - expense of family dental care including braces for the children.
8. College - the \$20,000 would be saved and invested over the 20 years to meet the anticipated college costs of \$89,000.

## APPENDIX C

### Scarcity

The family as an economic unit must decide on how to use their limited resources. These decisions are brought about by scarcity. Scarcity persists because the desire for goods and services exceeds production. Because of scarcity, the family economic unit must direct their flow of resources toward consumption now or investing for future consumption. The choice can bring a mixture of pleasure and pain because every use of the limited resources for one purpose means giving up the opportunity to use the resources for another purpose (Kohler, 1982, p. 21). The decision process leads the family economic unit to the application of the optimization principle. This principle is applied when people try to maximize the welfare they obtain from their limited resources. This is done by changing the level of an activity (i.e. spending more/less) so that the marginal benefit and the marginal cost are of equal value. The optimization principle is a subjective evaluation of a situation. It also can be an elusive goal when crucial information needed by a family decision maker is to utilize the information available. The presence of multiple decision makers (husband, wife and children) adds further complications to obtaining the optimal choices concerning the allocation of a family's limited resources.



### Utility, Risk and Uncertainty

Utility is the satisfaction a person derives from an activity (Kohler, 1982, p. 606). It has to do with one's preference for various decision alternatives. A Swiss mathematician, Daniel Bernoulli, argued that people making decisions under uncertainty were not attempting to maximize expected monetary values but maximize expected utilities instead. He thought that the marginal utility of money declines with the more money people have. A family starting with \$1000 would place a smaller subjective value on gaining an extra sum than losing an equal amount. Each person's utility function is their own unique function. When facing uncertainty, a knowledge of their utility functions would help predict their behavior. These utility functions reveal important information about people's attitudes concerning the variety of possible outcomes of their action around the action's expected value. People's attitudes toward such a spread, reveal their attitudes toward risk (Kohler, 1982, p. 280).

The more information one has about what will happen in the future, the less potential risk that an event or situation will cause a loss. Risk is a chance of a loss in the future. The degree of risk is simply a function of the amount of knowledge one has about future events. The main idea is that the more one knows about the future, the less risk one takes.

Risk is one factor that is very hard to quantify. The key question is what will be lost if an action is taken? Risk is

generally intuitively evaluated. An individual must make his own decisions about how much risk he is willing to accept and what is the expected gain. An important point is that risk and return are closely related. Low risk means low return and high risk means high return (Sparks, 1983, p. 84).

The basic purpose for saving present resources is to provide for future contingencies. These contingencies may be categorized as risk and opportunities. Risk can be the uncertainty of financial loss due to some kind of action. Opportunity means the financial ability to carry out certain desired activities which would optimize the family's limited resources. These activities could be sending a child to college or buying a home. If one avoids risk, one also avoids opportunity, because risk is the price paid for opportunity (Allen, 1983, p. 17).

#### Theory Application

The problems of financial management are economic in nature, because they involve the allocation of limited resources to the satisfaction of competing human wants. One scarce resource that the Navy and Marine Corps officer has to allocate is his income. Because officers must devote their full attention to military duties, they are not in a position to add income from outside employment (Officer's Manual, 1973, p. 20). The officer and his family can be thought of as an economic unit that depends on income of the officer to satisfy their needs.

Need determination is a matter of individual family decision based upon appraisals and value judgements. One family might consider a computer a necessity, while another might consider a second car more satisfying. These decisions are not susceptible to precise economic analysis; they depend upon the individual family's own value judgements.

The basic problem in financial management is how to optimize the allocation of income between current needs and savings for future contingencies. Both current expenditures and savings must be provided for out of current income or obligation of future income. If the officer knew he would be the last surviving member of his family and he would be employed until his death, he would not need to worry about future contingencies. However, with uncertainty (not knowing his life expectancy) the officer must somehow decide how to allocate his income to satisfy both his family's current economic needs while protecting his family against future uncertainty.

Since every officer is totally unique in his tolerance for risk and need for income, only he can decide how to allocate his income. Nobody knows (or cares) as much about the officer's finances as he does. He must learn to decide for himself rather than be led by some expert, no matter how knowledgeable or competent. The officer, knowing his own family's needs, can allocate his income by "balancing at the margin." This involves reviewing his present way of spending money and seeing if a portion of money from one category

may be reallocated to another. The question to ask is this: "Can I move dollars from one category of expenditures to another to increase the total satisfaction or benefit my family can derive from my income?" Satisfaction is defined in terms of the officer's family goals as determined by his family. The officer and his family make the decision on how to use money to satisfy their own goals.

It is easy for an officer to cease to assume personal responsibility for his financial well-being and assume that the government is responsible. The government provides housing, medical benefits, commissary, life insurance, pay raises and pensions. The officer can get caught in the euphoria of abundance by these provisions. This euphoria can go on until it is ended by the thought of putting his children through college or when the pay increases become smaller and less frequent (possible passover for a rank).

If it is not ended by those thoughts, the thought of retirement will remind the officer of the scarcity in the world. Scarcity is brought about when the government no longer provides government housing, when medical benefits are limited, when the cost of living allowances are cut and when the officer's pay is cut in half (after 20 years of service he can retire with 50% of base pay).

The officer should see that the government is not responsible for his financial well-being. The answer lies within his family and him as an economic unit. The officer and his

family, alone, are responsible for their ultimate financial welfare.

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